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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

HARRIS TRUST AND SAVINGS BANK, As Trustee of the Sperry Master Retirement Trust No. 2,

Cross-Petitioner,

vs.

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY,

Cross-Respondent.

CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

CROSS-PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Whether under the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1002(21)(A), an insurer is a fiduciary with respect to a group annuity contract over which the insurer has exercised contractual power in its sole and unfettered discretion and the exercise of such power affects the value of the contract to the plan.

Whether an insurer is an ERISA fiduciary (i) where the insurer manages a fund which commingles funds supporting guaranteed benefits with funds used for pension benefits which are not guaranteed by the insurer and (ii) where the investment income generated by the funds supporting guaranteed benefits is available for the purpose of providing pension benefits which are not guaranteed by any insurer.

PARTIES

The parties to the action below were Cross-petitioner Harris Trust and Savings Bank ("Harris Trust"); Cross-respondent John Hancock Mutual Life Insurance Company ("Hancock"); counterclaim defendant Chase Manhattan Bank, N.A. ("Chase"), which was succeeded as trustee of the Sperry Master Retirement Trust No. 2 on October 1, 1987, by Harris Trust; and third-party defendants Sperry Corporation ("Sperry") and The Retirement Committee of Sperry Corporation ("SRC").

The party to this brief, Harris Trust and Savings Bank, is acting as party to this appeal only in its capacity as Trustee of the Sperry Master Retirement Trust No. 2 (and of its successor, the Unisys Master Trust) (collectively the "Plan") and is not otherwise affected by the outcome of this litigation. The Bank of Montreal is a parent of Harris Trust and Savings Bank.

Hancock is a mutual insurance company; it does not have any parent companies or subsidiaries to list pursuant to Rule 29.1.

Cross-petitioner is not aware of any other parent companies or subsidiaries to list pursuant to Rule 29.1.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
PARTIES	ii
TABLE OF AUTHORITIES	v
CROSS-PETITION FOR A WRIT OF CERTIORARI	1
OPINIONS BELOW	2
JURISDICTION	2
STATUTES AND REGULATIONS INVOLVED	2
STATEMENT OF THE CASE	2
Factual Background	3
The Second Circuit Decision	6
REASONS FOR GRANTING THE WRIT	7
I THE SECOND CIRCUIT'S INTERPRETATION OF THE SCOPE OF ERISA'S FIDUCIARY PROVISIONS WITH RESPECT TO THE CONTRACT CLEARLY CONFLICTS WITH THE SEVENTH CIRCUIT	7
II HANCOCK IS AN ERISA FIDUCIARY WITH RESPECT TO ALL OF THE ASSETS IT HOLDS UNDER GAC 50	12
A. The Relevant Statutory Provisions	13

Page

B. The Seventh Circuit And The Jacobson Court Correctly Read ERISA As Protecting Assets Which Are Subjected To Investment Fluctuations Under Contracts Like GAC 50 16

C. GAC 50 Is Not An Insurance Policy Because Hancock Bears No Meaningful Risks 20

CONCLUSION 22

TABLE OF AUTHORITIES

CASES	Page
Blatt v. Marshall & Lassman, 812 F.2d 810 (2d Cir. 1987)	11
Bouton v. Thompson, 764 F. Supp. 20 (D. Conn. 1991)	11
Chicago Board Options Exch., Inc. v. Connecticut Gen. Life Ins. Co., 713 F.2d 254 (7th Cir. 1983)	*passim*
Ed Miniat, Inc. v. Globe Life Ins. Group, Inc., 805 F.2d 732 (7th Cir. 1986), *cert. denied*, 482 U.S. 915 (1987)	*passim*
F.H. Krear & Co. v. Nineteen Named Trustees, 810 F.2d 1250 (2d Cir. 1987)	10, 11
Jacobson v. John Hancock Mut. Life Ins. Co., 655 F. Supp. 1290, *withdrawn pursuant to settlement*, 662 F. Supp. 1103 (D. Conn. 1987)	17, 18, 19
Otto v. Variable Annuity Life Ins. Co., 814 F.2d 1127 (1986), *as amended on reh'g*, 814 F.2d at 1140 (7th Cir. 1987), *cert. denied*, 486 U.S. 1026 (1988)	20
Peoria Union Stock Yards Co. Retirement Plan v. Penn Mutual Life Ins. Co., 698 F.2d 320 (7th Cir. 1983)	16, 17, 21
SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967)	20
SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959)	20
Schulist v. Blue Cross, 717 F.2d 1127 (7th Cir. 1983)	9

CASES	Page
Smith v. CMTA-IAM Pension Trust, 746 F.2d 587 (9th Cir. 1984)	15
STATUTES	
Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 *et seq*	*passim*
29 U.S.C. § 1002(21)(A)	*passim*
29 U.S.C. § 1101(b)(2)	*passim*
Judiciary & Judicial Procedure, 28 U.S.C. § 1254(1)	2
N.Y. Ins. Law § 4240(a)(2)(A)(McKinney 1991)	14
RULES AND REGULATIONS	
Department of Labor Advisory Opinion 83-51A (Sept. 21, 1983)	19
Department of Labor Advisory Opinion 78-8A (Mar. 15, 1978)	20
LEGISLATIVE MATERIALS	
H. Rep. No. 93-1280, 93d Cong., 2d Sess. (1974), *reprinted in* 1974 U.S. Code Cong. & Admin. News 5038	14
S.4, 93d Cong., 1st Sess. § 511 (1973), *reprinted in* 1 Legis. Hist. of ERISA (Comm. Print 1976)	13

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CROSS-PETITION FOR A WRIT OF CERTIORARI

Cross-petitioner Harris Trust respectfully cross-petitions for a writ of certiorari to review so much of the judgment of the United States Court of Appeals for the Second Circuit as determined that Cross-respondent Hancock is not a fiduciary pursuant to the fiduciary responsibility provisions of ERISA, with respect to (i) a certain group annuity contract issued to Harris Trust known as "GAC 50" or the "Contract" and (ii) all of the funds held by Hancock that are associated with GAC 50.

OPINIONS BELOW

The opinion of the court of appeals is reported at 970 F.2d 1138. A-1.[1] The two opinions of the district court are reported at 722 F. Supp. 998 ("Harris I") (A-21), and 767 F. Supp. 1269 ("Harris II") (A-63); the judgment of the district court was entered on August 16, 1991 (A-89).

JURISDICTION

The judgment of the court of appeals was entered on July 30, 1992 (A-19). The court of appeals denied Hancock's petition for rehearing and suggestion for rehearing *in banc* on September 23, 1992 (A-91). This Cross-petition for a Writ of Certiorari is filed pursuant to Supreme Court Rule 12.3 in connection with Hancock's Petition for a Writ of Certiorari, filed December 22, 1992, and served upon Harris Trust on December 22, 1992 ("Hancock Petition" or "HP"). The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1). This petition is filed within the time allowed by law.

STATUTES AND REGULATIONS INVOLVED

The following statutory provisions are invovled in the case and are fully set forth in the Hancock Petition in the Appendix beginning at A-93: 29 U.S.C. § 1002 (21)(A) and 1101 (b)(2).

STATEMENT OF THE CASE

Harris Trust seeks review of a decision of the Court of Appeals for the Second Circuit that Hancock is not a fiduciary under the fiduciary responsibility provisions of ERISA with respect to (i) a group annuity contract over which Hancock has exercised contractual power in its sole and unfettered discretion and (ii) all of the funds held and invested by Hancock under GAC 50.

With respect to the first issue, the Second Circuit decision directly conflicts with a series of decisions of the Seventh

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[1] "A-____" refers to the pages of the Appendix annexed to Hancock's Petition for a Writ of Certiorari, Docket No. 92-1074, filed with the Court on December 22, 1992.

Circuit, each of which holds that an insurer's exercise of discretionary control over a group annuity contract subjects the insurer to ERISA's fiduciary obligations where the exercise of that discretion alters the pension plan's rights under the contract or the value of the contract to the plan. By refusing to find that Hancock is a fiduciary with respect to the contract, the Second Circuit's has left the Plan at the mercy of Hancock's Unilateral exercise of discretion with respect to fundamental issues concerning the handling of pension investment funds. In effect, the decision below allows Hancock to exercise its unfettered discretion in allocating income and expenses to GAC50, and in controlling the way in which free funds held by Hancock are used by the Plan. The Second Circuit's construction renders contractholders like the Plan hostage to potential self-dealing and other breaches of fiduciary duty, with all of the risk borne by the contractholder and, hence, the pension beneficiaries.

On the second issue, without addressing it directly, the Second Circuit implicitly held that, although the funds not supporting guaranteed benefits were plan assets subjecting Hancock to ERISA fiduciary responsibility, the balance of the funds held by Hancock were not plan assets. This result conflicts with a decision of the Seventh Circuit and with a District Court decision in the Second Circuit. Furthermore, the decision exempts from ERISA potentially hundreds of billions of dollars, that are invested in insurance company general accounts for the purpose of providing pension benefits which, as discussed below, are not guaranteed by any insurer. As such, the decision conflicts with the central tenets of ERISA.

Factual Background

Hancock and Sperry Rand Corporation[2] entered into GAC 50 in 1941. A discussion of GAC 50's terms and amendments is contained in the Second Circuit's decision (A-4-6), which is

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[2] Sperry Rand Corporation was succeeded by Sperry Corporation (collectively "Sperry") and later the Trustee as the contractholder of GAC 50.

hereby incorporated. A few factual issues however, were stated either incorrectly or not mentioned at all in the decision. Those matters are discussed below.

Pursuant to the 1968 Amendment ("68 Amendment"), Hancock placed the assets supporting annuities purchased prior to 1968, which were cancelled pursuant to the 68 Amendment, in a Pension Administration Fund ("PAF" or "PA Fund") and a Contingency Account assigned to GAC 50.[3] Hancock annually allocated net investment income to GAC 50's PA Fund on the funds in the PA Fund *and* Contingency Account. J.A. 530, 545.[4] The Second Circuit's statement that "Hancock in effect guaranteed that the PAF would never fall below its January 1, 1968 level" is incorrect. A-5. Hancock never provided any guarantee of a minimum investment return under GAC 50 nor a real guarantee of principal. Hancock in fact only "guaranteed" that the PA Fund would never be less than its starting balance, plus any contributions by the Plan, minus all expenses and benefit payments made from the PA Fund. J.A. 655-57. Thus, the "principal" that was guaranteed dropped progressively as benefits were paid, although the size of the PA Fund was increasing due to investment income credited to the PA Fund. J.A. 529-30.

Although not stated by the Second Circuit, the LOF[5] for the benefit obligations attributable to GAC 50 was and still is computed using extraordinarily low investment return assumptions

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[3] The 1968 starting balance of the PA Fund was $108 million; thereafter, only nominal contributions were ever made to that fund. J.A. 529, 531, 655-656.

[4] "J.A. ____" refers to the pages of the parties Joint Appendix submitted in connection with the appeal to the Second Circuit.

[5] LOF (the "Liabilities of the Fund") is a contractual reserve for the Plan's possible future purchase of annuities in the event the contract is ever terminated. The LOF assumptions of interest, mortality and expenses become the purchase rates for such annuities in the event of termination.

of 2.5 and 3 percent.[6] J.A. 525, 531-532. Hancock refers to the amount in the PA Fund in excess of 105% of LOF as "free funds" or "free money." J.A. 250-56, 1102. Under a subsequent amendment (the "77 Amendment"), the Plan had the exclusive right on a prospective basis to select Plan participants to receive "non-guaranteed benefits" from the free funds in the PA Fund. J.A. 543-44.

Because the LOF was set at a far higher level than necessary and because the PA fund was earning at far higher actual rates than the present value interest assumptions used for computing the LOF, the level of free funds in the PA Fund continued to increase throughout the 1970's. In that same period Hancock instituted a "rollover" procedure whereby, under certain circumstances, Hancock would permit the annual withdrawal of positive cash flow from a contractholder's PA Fund. Hancock allowed two withdrawals under the rollover procedure — in 1979 and 1981. Hancock subsequently eliminated the procedure in 1982. J.A. 444-47, 542-43, 1107, 1382-86.

In order to utilize the "free funds" in GAC 50 without triggering the purchase of what it believed to be greatly over-priced annuities, the SRC amended the Plan in early 1982 to add additional Plan participants to the group eligible to receive non-guaranteed benefits under GAC 50 and requested payment of non-guaranteed benefits to these additional beneficiaries from the PA Fund's free funds. After paying two months of the additional benefits, Hancock unilaterally terminated all future payments of non-guaranteed benefits under the 77 Amendment. J.A. 544, 1114-16. As a result of Hancock's elimination of the rollover procedure and its termination of non-guaranteed benefit payments, the Plan had no means of withdrawing any of the Contract's continually increasing free funds without terminating the Contract and causing the purchase of annuities at grossly

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[6] LOF interest assumptions are used to calculate as of a specific point in time the present value of the probable stream of benefits to be paid in the future to retirees. The interest assumptions should predict the rate at which money grows. The lower the interest assumptions, the higher the present value of future benefits and, thus, the amount which must be maintained in the PA Fund to support future benefit payments.

inflated prices. Thus, Hancock had exclusive control of the Plan's access to free funds held under GAC 50 and in so doing determined the value of GAC 50 to the Plan and the availability to the Plan of funds to pay benefits.

The Second Circuit Decision

Although the Second Circuit held that GAC 50 is a "plan asset," the court failed to hold that Hancock was a fiduciary with respect to its discretionary power under the Contract itself. In considering Hancock's obligations with respect to the Contract, the Second Circuit altered the statutory standard, requiring "power unilaterally to alter or amend" the policy rather than simply "discretionary authority or discretionary control . . . respecting management or disposition of" the policy, as set forth by ERISA (A-14). The Second Circuit acknowledged the decisions of the Seventh Circuit in *Ed Miniat, Inc. v. Globe Life Insurance Group, Inc.*, 805 F.2d 732 (1986), *cert. denied*, 482 U.S. 915 (1987) and *Chicago Board Options Exchange, Inc. v. Connecticut General Life Insurance Co.*, 713 F.2d 254 (1983) ("*CBOE*"), but departed from that court's proper application of ERISA's fiduciary provisions. Finding that Hancock did not have unilateral power to alter or amend the policy, the Second Circuit held that, therefore Hancock is not an ERISA fiduciary with respect to the contract itself.

Nevertheless, in reversing the district court, the Second Circuit held that Hancock is subject to ERISA's fiduciary obligations with respect to "the administration or management of plan assets not referable to guaranteed benefits." A-14. As such, since "free funds" are not immediately required to guarantee benefit payments to Plan participants and because they are subject to fluctuation based upon Hancock's investment performance, the Second Circuit reasoned that Hancock has ERISA fiduciary duties with respect to the administration and management of such funds. A-10-11. The court, however, declined to hold that all of the assets held by Hancock under GAC 50 are plan assets. A-8.

Jurisdiction in the court of first instance was based on Federal questions with respect to ERISA claims, 28 U.S.C. § 1331 and 29 U.S.C. § 1132, and diveristy with respect to common law claims, 28 U.S.C. § 1332(a)(1).

REASONS FOR GRANTING THE WRIT

I.

THE SECOND CIRCUIT'S INTERPRETATION OF THE SCOPE OF ERISA'S FIDUCIARY PROVISIONS WITH RESPECT TO THE CONTRACT CLEARLY CONFLICTS WITH THE SEVENTH CIRCUIT

The Second Circuit decision in this case directly contradicts the Seventh Circuit's decisions in *Ed Miniat*, *CBOE* and their progeny. In each of its decisions, the Seventh Circuit has clearly held that, under ERISA § 1002(21)(A), to the extent that an insurance company exercises discretionary authority or control over a group annuity contract, the insurance company is subject to the fiduciary provisions of ERISA. The Court below, however, refused to apply the fiduciary duty provisions of ERISA unless the insurance company had the "power unilaterally to alter or amend" the plan asset in its entirety. A-14. As a result, the court has opened an enormous gap in the protections afforded by ERISA's fiduciary rules.

The Second Circuit invoked the appropriate ERISA provision setting forth when fiduciary obligations are triggered, only to misconstrue it. ERISA defines a fiduciary as follows:

> a person is a fiduciary with respect to a plan *to the extent* . . . he exercises any discretionary authority or discretionary control respecting management of such plan or *exercises any authority or control respecting management or disposition of its assets*. . . .

29 U.S.C. § 1002(21)(A) (emphasis added). A-93. While the Second Circuit correctly characterized GAC 50 as a "plan asset,"[7] it misapplied ERISA § 1002(21)(A) to GAC 50.

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[7] ERISA § 1101(b)(2) provides that "[i]n the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy . . ." A-94.

GAC 50 clearly conferred upon Hancock broad and unfettered discretion to alter Harris Trust's rights under the contract including power (i) to permit or deny the withdrawal of excess funds through the "rollover" arrangement, (ii) to terminate the payment of non-guaranteed benefits and (iii) to make investment income and expense allocation decisions. *Harris II*, 767 F. Supp. at 1275-76, 1278, 1281-83. In fact, the Second Circuit affirmed the district court's decision that Hancock had unfettered discretion to terminate the payment of non-guaranteed benefits, in effect cancelling the 77 Amendment. At a minimum, then, Hancock undeniably had discretionary authority and control over GAC 50. Under the Seventh Circuit's clear interpretation of ERISA § 1002(21)(A), therefore, Hancock is without question a fiduciary *to the extent* it has exercised such discretionary authority or control.

The Second Circuit failed to apply the express terms of ERISA § 1002(21)(A). Instead, the Second Circuit decision attempted to distinguish *Ed Miniat* and *CBOE*, while losing sight of the ERISA fiduciary provisions. In both *Ed Miniat* and *CBOE*, the insurer manifested its discretionary authority and control over the contract at issue by unilaterally amending it: in *Ed Miniat*, the insurer reduced the annuity Contract's rate of return and increased the annual premium rates; in *CBOE*, the insurer locked the contractholder into certain "guaranteed" accounts for ten years. The proposition for which *Ed Miniat* and *CBOE* stand, however, is not that ERISA's fiduciary obligations will be triggered *only* where an insurance company has exercised its unilateral authority to *amend* the contract, as the Second Circuit suggests. To the contrary the exercise of the authority to amend or alter the contract simply is an example of the type of power that triggers ERISA's fiduciary provisions. *CBOE* and *Ed Miniat*, however, cannot be read as limiting the reach of § 1002(21)(A) to the specific instances at issue in those cases.

While the nature of the discretionary authority and control exercised by Hancock is different from that exercised by the insurers in *Ed Miniat* and *CBOE*, Hancock nonetheless exercised unfettered power over GAC 50, giving rise to precisely those

consequences which ERISA protects against and which the Seventh Circuit has repeatedly sanctioned. The failure to impose a fiduciary duty upon Hancock in essence has left the *value* of GAC 50, a plan asset, entirely at the mercy of Hancock.

Indeed, Hancock's ability to exercise complete discretion regarding whether to permit or deny withdrawals of excess non-guaranteed funds from its general account – in effect to fundamentally alter the value of GAC 50 – "is not qualitatively different from the ability to choose investments." *CBOE*, 713 F.2d at 260. To further paraphrase the Seventh Circuit, Hancock, by "locking [GAC 50's excess funds] into the [General Account,] . . . has effectively determined what type of investment the Plan must make. In exercising this control over an asset of the plan, [Hancock] must act in accordance with its fiduciary obligations." *CBOE*, 713 F.2d at 260.

In substituting its own construction of ERISA, the Second Circuit also held that ERISA's fiduciary obligations are not invoked in a case where the insurer "can act only under the terms of the policy. . . ." A-14. That an insurer acts under the terms of a contract, as the Seventh Circuit correctly instructs, in no way limits the reach of ERISA's fiduciary provisions. While adherence by an insurer to a specific term in a contract, bargained for at arm's length, is not a breach of fiduciary duty, the exercise of *discretionary authority* under a contract may create fiduciary obligations. Explaining its decision in *Schulist v. Blue Cross*, 717 F.2d 1127 (7th Cir. 1983), the Seventh Circuit in *Ed Miniat* stated:

> The defendants in effect argue that no action by an insurer can subject it to fiduciary liability so long as discretion to take the action was granted to it by contract and the contract was entered into at arm's length. This reading of *Schulist* is incorrect. Rather. *Schulist* stands for the proposition that if a specific term (not a grant of power to change terms) is bargained for at arm's length, adherence to that term is not a breach of fiduciary duty. No discretion is

> exercised when an insurer merely adheres to a specific contract term. *When a contract, however, grants an insurer discretionary authority, even though the contract itself is the product of an arm's length bargain, the insurer may be a fiduciary.*

805 F.2d at 737 (emphasis added); *see also F.H. Krear & Co. v. Nineteen Named Trustees*, 810 F.2d 1250, 1259 (2d Cir. 1987) (citing *Schulist* with approval). Hancock has, in almost identical fashion to the insurers in *CBOE* and *Ed Miniat*, acted pursuant to its "rights under the contract." The Second Circuit's suggestion that ERISA's fiduciary provisions are not applicable because Hancock's power "was referable to the terms of [the] policy" represents, at best, a tortured reading of the statute. A-14.

Furthermore, the Second Circuit's conclusion that only the contractholder may be held to fiduciary standards unless the insurer has the power to unilaterally amend the contract runs counter to both the language of ERISA and countless cases concerning the statute's definition of a fiduciary. The Second Circuit's conclusion rests upon a single passage in the legislative history which on its face indicates that, although a trust need not be established to hold plan assets consisting of an insurance contract or policy, the person "who holds the contract is to be a fiduciary. . . ." A-14. This passage does not support the Second Circuit's conclusion that the only fiduciary is the contractholder. Indeed, the statute itself and case law interpreting ERISA are to the contrary.

ERISA clearly envisioned circumstances in which there would be multiple fiduciaries. Section 1002(21)(A), for example, provides that "a person is a fiduciary with respect to the plan to the extent (i) he exercises *any* discretionary authority or discretionary control respecting management of such plan or exercises *any* authority or control respecting management or disposition of its assets. . . ." (emphasis added). A-93. Similarly, Section 1105 sets forth the circumstances under which a fiduciary may be held liable for the misconduct of a co-fiduciary. Although ignored by the Second Circuit, this statutory scheme contradicts the conclusion that *only* the contractholder may be deemed a

fiduciary with respect to a group annuity contract. Furthermore, the Second Circuit ignored the remedial nature of ERISA and the requirement that, as such, its remedial provisions are to be broadly construed. *E.g.*, *Bouton v. Thompson*, 764 F. Supp. 20, 22 (D. Conn. 1991).[8]

Moreover, in concluding that *only* the contractholder may be deemed a fiduciary with respect to the contract itself, the Second Circuit ignored *CBOE*, *Ed Miniat* and their progeny, where the Seventh Circuit held that an insurance company in certain circumstances is a fiduciary with respect to the administration of a group annuity contract. Thus, even if *CBOE* and *Ed Miniat* were distinguishable on their facts from this case, the mere fact that the insurers *and* the contractholders were found to be fiduciaries as to the group annuity contracts at issue in those cases contradicts the Second Circuit's holding.

Finally, Hancock's decision to retain free funds by terminating the "rollover" arrangement and the payment of non-guaranteed benefits substantially increased its compensation, by raising its risk charge and expense recoveries and improving its cash flow. As the Second Circuit itself previously held in *F.H. Krear*, a party's ability to protect its cash flow and to enhance its fees and charges is effectively a determination of the amount of its compensation and, in this case, most certainly rendered Hancock a fiduciary:

> On the other hand, *after* a person has entered into an agreement with an ERISA-covered plan, the *agreement may give it such control* over factors that determine the actual amount of its compensation that the person thereby *becomes an ERISA fiduciary* with respect to that compensation.

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[8] *Accord Blatt v. Marshall & Lassman*, 812 F.2d 810, 812 (2d Cir. 1987) ("Congress intended the term [fiduciary] to be broadly construed. '[T]he definition includes persons who have authority and responsibility with respect to the matter in question, regardless of their formal title.' ") (*quoting* H.R. Rep. No. 1280, 93d Cong. 2d Sess., *reprinted in* 1974 U.S. Code Cong. & Admin. News 4639, 5038, 5103); *F.H. Krear*, 810 F.2d at 1259.

810 F.2d at 1259 (emphasis added) (citing *Sixty-Five Security Plan v. Blue Cross & Blue Shield*, 583 F. Supp. 380, 387-88 (S.D.N.Y. 1984).

Hancock exercised unfettered control over the value of GAC 50 by locking in substantial free funds into Hancock's General Account. Hancock's complete discretion with respect to its own compensation, in the face of which the Plan can only sit idly by and hope for the best, presents precisely the unconscionable scenario that ERISA was intended to prevent. While the Seventh Circuit has appropriately upheld these integral fiduciary provisions in virtually identical situations, the Second Circuit has erred in its failure to properly construe ERISA. The Second Circuit's decision leaves open the possibility that any insurance company can evade its fiduciary obligations simply by inserting discretionary terms into those contracts which, like other insurance contracts and policies, are largely contracts of adhesion.

II.

HANCOCK IS AN ERISA FIDUCIARY WITH RESPECT TO ALL OF THE ASSETS IT HOLDS UNDER GAC 50

The Second Circuit correctly held that the free funds held by Hancock are "plan assets," the discretionary management of which subjects Hancock to ERISA.[9] Nevertheless, the decision did not go far enough. As discussed below, all of the funds held by Hancock are invested by Hancock for the purpose of generating free funds, which are not associated with any benefits guaranteed by Hancock. Since 1968, no traditional annuities were ever purchased from Hancock; both guaranteed and non-guaranteed benefits were paid directly from the PA fund. Therefore, all such funds are subject to investment risk and all are plan assets governed by ERISA's fiduciary responsibility rules.

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[9] This portion of the opinion below is the subject of Hancock's Petition for a Writ of Certiorari dated December 22, 1992.

As of 1991, the insurance industry held over 500 billion dollars in pension assets in general account contracts, most commonly under the type of contract here in issue. Amicus Brief of the American Council of Life Insurance, submitted on appeal below, dated August 13, 1992. Thus, the issue presented here is of enormous significance in that potentially hundreds of billions of dollars in pension assets may be left beyond the scope of ERISA protection.

A. The Relevant Statutory Provisions

ERISA defines a fiduciary as:

> [A] person is a fiduciary with respect to a plan to the extent . . . he exercises any discretionary authority or discretionary control respecting management of such plan or *exercises any authority or control respecting management or disposition of its assets*. . . .

29 U.S.C. § 1002(21)(A) (emphasis added). A-93. Congress adopted a limited "safe harbor" provision in ERISA for certain pension fund assets held in insurance company general accounts:

> In the case of a plan to which a *guaranteed benefit policy* is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, *solely* by reason of the issuance of such policy, be deemed to include any assets of the insurer.

29 U.S.C. § 1101(b)(2) (emphasis added).[10] A-94. "Guaranteed benefit policy" is defined in the statute as: "an insurance policy or contract *to the extent that* such policy or contract provides for benefits the amount of which is guaranteed by the insurer." 29 U.S.C. § 1101(b)(2)(B) (emphasis added). A-94.

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[10] A provision in the Senate Bill would have explicitly exempted *all* assets held in general accounts from ERISA's fiduciary duty provisions. *See* S.4, 93d Cong., 1st Sess. § 511 (1973), *reprinted in* 1 Legis. Hist. of ERISA at 170 (Comm. Print 1976). This provision was deleted and replaced by the more limited "guaranteed benefit policy" exemption. 29 U.S.C. § 1101(b)(2).

In enacting ERISA Congress intended to make a distinction between funds held under "guaranteed benefit policies" and funds held under other insurance company general account pension contracts.[11] In using the term "guaranteed benefit policy," Congress recognized a distinction between those insurance company general account contracts which truly guarantee benefits to retirees, and those like GAC 50 which participate in the insurer's investment experience. The ERISA Conference Report states:

> If the policy guarantees basic payments but other payments may vary with, e.g., investment performance, then *the variable part of the policy and assets attributable thereto* are not to be considered as guaranteed, and are to be considered as plan assets subject to the fiduciary rules.

H. Rep. No. 93-1280, 93d Cong., 2d Sess. (1974), *reprinted in* 1974 U.S. Code Cong. & Admin. News 5038, 5077 (emphasis added) ("ERISA Conf. Rep.").

Thus, the crucial question in determining whether assets invested by the Plan are "plan assets" is whether the availability of funds for benefits is dependent upon Hancock's success or failure as an investor, rather than upon any role it may have as an insurer. Following this standard, all of the assets held by Hancock under GAC 50 are clearly "plan assets."

First, because the assets backing the guarantees are invested by Hancock in order to generate additional free funds, all of the funds held by Hancock are also plan assets and thus Hancock's discretionary management of such funds subjects it to

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[11] Under ERISA all pension plan assets held in separate accounts are "plan assets" and therefore subject the insurance company to the full panoply of ERISA's fiduciary duty provisions. *See* 29 U.S.C. § 1101(b)(2)(B). Separate accounts are investment funds which are permitted to invest in different types of assets than general accounts. *See, e.g.*, N.Y. Ins. Law § 4240(a)(2)(A)(McKinney 1991). Many separate accounts are used exclusively by pension plans.

ERISA's fiduciary rules. Second, because Hancock has chosen to commingle assets backing its guarantees with those representing free funds, it must assume fiduciary responsibilities with respect to all such funds.

The amount in GAC 50's PA Fund available to fund benefits is dependent upon the investment experience of the Hancock General Account and allocation of that experience to the PA Fund. A-5. The monies allegedly supporting benefits "guaranteed" by Hancock and the "free money" which may be used to provide future guaranteed or non-guaranteed benefits are all held in the PA Fund, and it is the entire PA Fund which receives the benefits and detriments of Hancock's investment performance. J.A. 1641-1674 (the 68 Amendment). Indeed Hancock's own experts agreed with the characterization of contracts such as GAC 50 as "investment vehicles." J.A. 591-96.

The funds supporting the benefits "guaranteed" by Hancock and the "free funds" in excess of the Minimum Level are commingled and invested together by Hancock. The *entire* fund earns income and generates additional "free funds." Thus, the monies held by Hancock under GAC 50 should not be compartmentalized into those supporting a "guaranteed benefit policy" and those supporting variable aspects of the contract. Furthermore, since the earnings on the Contingency Account are also credited to the PA Fund and contribute to the generation of "free funds" which support non-guaranteed benefits and any future guaranteed benefits, the funds in the Contingency Account are also plan assets.

Because Hancock does not attempt to segregate the variable, non-guaranteed portion of GAC 50's funds, the entire PA Fund and Contingency Account should fall within the broad remedial requirements of ERISA's fiduciary responsibility provisions. *See, e.g., Smith v. CMTA-IAM Pension Trust*, 746 F.2d 587 (9th Cir. 1984). Accordingly, as in *Peoria*, the entire PA Fund should be considered to be in the "variable accumulation phase," thereby subjecting Hancock to ERISA's fiduciary duty provisions.

B. The Seventh Circuit And The *Jacobson* Court Correctly Read ERISA As Protecting Assets Which Are Subject To Investment Fluctuations Under Contracts Like GAC 50

In *Peoria Union Stock Yards Co. Retirement Plan v. Penn Mutual Life Insurance Co.*, 698 F.2d 320, 327 (7th Cir. 1983), the Seventh Circuit set forth for the first time the theoretical basis for holding an insurer to fiduciary standards with respect to its management of general account funds.

Peoria involved a deposit administration fund ("DA Fund") in which pension funds were "commingled for investment purposes with the funds of other customers of the insurance company, in much the same way as investments of different investors are pooled in a mutual fund or common trust fund, in order to obtain diversification while minimizing brokerage and management costs." 698 F.2d at 322. Once an employee retired, annuities were purchased and the purchase price for such annuities was removed from the DA Fund account. The DA Fund no longer received the benefit of the insurer's investment experience on the funds so removed. Thus, no payments to beneficiaries were made from the DA Fund.

In such circumstances, the Seventh Circuit held that, while the funds in issue were kept in the DA Fund, the contract was in a variable accumulation phase and did not constitute a "guaranteed benefit policy," because the insurer had investment discretion and the results of that investment discretion would determine the amount of funds available to the pension plan:

> The pension trustees did not buy an insurance contract with a fixed payout; they turned over the assets of the pension plan to [the insurance company] to manage with full investment discretion, subject only to a modest income guaranty. If the pension plan had hired an investment advisor and given him authority to buy and sell securities at his discretion for the plan's account, the advisor would be a fiduciary within the

> meaning of the act, and that is essentially what the Trustees did during the accumulation phase of the contract with [the insurance company].

698 F.2d at 327.

The *Peoria* court found that the minimal guarantees of investment return made by the insurance company (declining from 7½ to 3½ percent in the first three years and none thereafter) were not meaningful. *Id.* at 324-25. The investment return guarantees in GAC 50 are far lower than those in the *Peoria* contract. The only investment guarantee in GAC 50 is a meaningless so-called "guarantee of principal" which in fact does not guarantee principal. Hancock itself, in describing GAC 50, has repeatedly stated, "[T]he nature of the funding medium places the *employer* [now the plan] on the risk for the plan experience." J.A. 271, 293, 316, 333, 350, 366, 382, 399 and 428.

In *Peoria*, the contract separated the assets supporting guaranteed benefits from those in the non-guaranteed accumulation phase. That is not true of GAC 50. Therefore, because all of the pension funds held under GAC 50 are held and invested in such a way that the entire PA Fund generates investment income for the Plan, the PA Fund should not be bifurcated for the purpose of determining Hancock's fiduciary duties. Hancock, unlike the insurer in *Peoria*, should be held to fiduciary standards with respect to all of the assets held under GAC 50.

The principles articulated in *Peoria* as described above have been applied in the context of a contract nearly identical to GAC 50. *Jacobson v. John Hancock Mut. Life Ins. Co.*, 655 F. Supp. 1290, withdrawn pursuant to settlement, 662 F. Supp. 1103, 1112-13 (D. Conn. 1987). In *Jacobson*, the plaintiff pension plan trustees alleged that Hancock was a fiduciary with respect to the contract and the funds held thereunder. The *Jacobson* court granted partial summary judgment holding that Hancock was an ERISA fiduciary as to all of the funds held under that contract. Hancock then settled with the trustees and the opinion was withdrawn pursuant to that settlement.

Initially, the *Jacobson* court noted that the guaranteed benefit policy exemption "does indeed provide a safe harbor to insurance companies that sell *standard annuity* contracts. . . ." 662 F. Supp. at 1107 (citing *Peoria*) (emphasis added). *Jacobson*, however, following the reasoning of *Peoria*, rejected the argument that *all* of the funds held under the contract enjoyed this "safe harbor." The court held that the contract was *not* a "guaranteed benefit policy" while "the level of funds available to support benefits which may become due fluctuates with the investment return of the insurer." 662 F. Supp. at 1108.

The PA Fund here, like its counterpart in *Jacobson*, "fluctuates with the investment return of the insurer," and thus is not a guaranteed benefit policy.

The *Jacobson* decision argues forcefully for this result:

> [U]nlike the guaranteed annuity contract, benefits of any or all participants are not guaranteed under GAC 738 so long as the fund contributions are subject to the investment results achieved by the insurer. Poor investment results might reduce or even exhaust funds below the level sufficient to pay benefits as they become fixed and payable. It is this contingency which § 1101(b)(2) addresses. That section must be read as written, vis [sic], to cover only that phase of a contract in which the obligation of the insurer to guarantee the benefits payable to plan participants is fixed. To construe the language "to the extent that" to apply to all stages of GAC 738 would exonerate defendant from the fiduciary obligation while it is managing and investing the plan contributions, when it has not guaranteed participants' benefits and while the contributions are subject to the risks of its investment decisions. Performance of aspects of a plan which does not guarantee benefit payments or a fixed rate of return, but provide [sic] for the insurer's management of the assets until they are converted to a guarantee of the payment of benefits, cannot be sheltered under this section.

Jacobson, 662 F. Supp. at 1108.

This analysis is supported by rulings of the Department of Labor ("DOL"), which is charged with enforcement of the fiduciary provisions of ERISA. For example, the DOL has clearly employed the distinction between "guaranteed" and variable payments to distinguish between funds which are plan assets and those which are not. The DOL has stated,

> [A] separate account would not hold "plan assets" for purposes of the fiduciary responsibility provisions of ERISA if it is maintained by an insurance company solely in connection with its fixed contractual obligations and if neither the *amount payable to* (or credited to) *the plan* or to any participant or beneficiary of the plan (including an annuitant) *is affected in any way by the investment performance of the separate account*. We note, however, that a conventional separate account (which holds contributions received from a plan and provides for the crediting of income on such amounts based upon the investment experience of the separate account) *would not be considered to be maintained in connection with a fixed contractual obligation of the insurance company merely because assets of the separate account are ultimately applied to provide fixed annuities to participants*, and the assets of such a separate account would be considered to be plan assets.

DOL Advisory Opinion 83-51A (Sept. 21, 1983) (emphasis added). The crucial distinction is thus whether the insurance company exercises *investment control* and whether the insurance company's investment performance affects the amount of funds available to the Plan and its participants.[12]

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[12] In Advisory Opinion 78-8, the DOL stated that:

> The [Conference Report on section 1101(b)(2) of ERISA] evidences a Congressional intent that when an insurance company provides

(Footnote continued)

At least two important points are revealed by 83-51A. First, it is clear that the DOL considers significant "the extent to which" investments in separate accounts are *actually* "*guaranteed*." Second, the DOL has recognized that the mere fact that fixed annuities will eventually be purchased with assets from an account does *not* make the entire policy a "guaranteed benefit policy" for purposes of the exemption in § 1101(b). A-12.

Clearly, all of the assets held by Hancock under GAC 50 are invested in Hancock's sole discretion and all such assets support the non-guaranteed aspects of the contract. Thus, all such assets should be held to be "plan assets" as to which Hancock bears fiduciary responsibility.

C. GAC 50 Is Not An Insurance Policy Because Hancock Bears No Meaningful Risks

In any event, § 1101(b)(2)(B)'s safe harbor should not apply because GAC 50 is an investment contract, not an insurance policy. Hancock sold the 68 Amendment on the basis that it was an investment vehicle,[13] J.A. 273-80, 252-55, and Hancock's own expert witnesses recognized that contracts such as GAC 50 are promoted by the insurance industry as *investment vehicles*. J.A. 591-96. A review of GAC 50's so-called guarantees shows that Hancock bears no meaningful risk. Therefore, GAC 50 is not an "insurance policy or contract," much less a "guaranteed benefit policy." As this Court has pointed out, there is "a basic

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> investment advice which determines the rate of return to the plan and its participants, the assets in the account shall constitute plan assets so that the insurance company is subject to the fiduciary responsibility provisions of the Act.

DOL Advisory Opinion 78-8A (Mar. 13, 1978).

[13] In the securities law area, courts have long analyzed insurance products to determine whether they are either insurance policies or investment contracts. *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967); *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 71 (1959); *Otto v. Variable Annuity Life Ins. Co.*, 814 F.2d 1127 (1986), as amended on rehearing, 814 F.2d at 1140 (7th Cir. 1987), *cert. denied*, 486 U.S. 1026 (1988).

difference between a contract which is to some degree insured and a contract of insurance". *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 211 (1967).

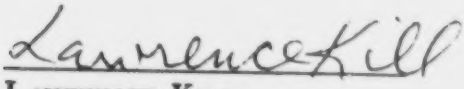
The notion that there is any meaningful investment risk to Hancock under GAC 50 is groundless. The LOF investment return assumptions contained in GAC 50 for the pre-68 annuities are 2.5 and 3 percent. As a matter of basic economics, this means that Hancock assumed no investment risk under the Contract and has not since before ERISA was enacted in 1974. The Seventh Circuit in *Peoria* found, with much higher investment guarantees, no investment risk. *Peoria*, 698 F.2d at 324-25.

CONCLUSION

For all the foregoing reasons, Harris Trust respectfully requests that the Court issue a writ of certiorari as prayed for herein to review the judgment of the United States Court of Appeals for the Second Circuit.

Dated: New York, New York
January 21, 1993

Respectfully submitted,



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